

AMENDED IN ASSEMBLY APRIL 29, 2003

CALIFORNIA LEGISLATURE—2003–04 REGULAR SESSION

ASSEMBLY BILL

No. 665

Introduced by Assembly Member Correa

February 19, 2003

An act to amend Section 5000.5 of the Business and Professions Code, and to amend Section 301 of, and to add Sections 171.09, 301.1, 301.2, 311.1, 311.2, 311.3, 319, 320, 606, 1513, and 2118 to, the Corporations Code, relating to ~~corporations~~ *professional and vocational boards*.

LEGISLATIVE COUNSEL'S DIGEST

AB 665, as amended, Correa. ~~Corporations: directors and officers~~
Professions and vocations: California Board of Accountancy: members.

(1) Existing law provides for the licensing and regulation of accountants by the California Board of Accountancy. Existing law provides that a public member of the board may not be a current or former licensee of the board, or a person currently or formerly employed by a public accounting firm, bookkeeping firm, or tax preparation firm.

This bill would also preclude a person from being a public member of the board ~~who if he or she~~ represents a public accounting firm, bookkeeping firm, or tax preparation firm.

(2) ~~Existing law, the General Corporation Law, provides for the regulation of corporations incorporated under California law and imposes certain requirements on foreign corporations incorporated under laws of other jurisdictions. Under existing law, the business~~

~~affairs of a California corporation are managed and all corporate powers are exercised by or under the direction of the board of directors. Existing law sets forth specified requirements for members of the board of directors.~~

~~This bill, with respect to a corporation incorporated under California law that not listed on the New York Stock Exchange, would require, on and after January 1, 2006, a majority of the corporation's board of directors to be independent directors, as defined, and would require the independent directors to meet at regularly scheduled executive sessions. The bill would also require the corporation to publicly disclose certain corporate governance guidelines, and would require the corporation to adopt and disclose a code of business conduct and ethics for its directors, officers, and employees and to disclose any waivers of the code.~~

~~This bill would require the corporation to have a nominating corporate governance committee, composed entirely of independent directors, with the purpose of identifying and recommending director nominees. The bill would require the corporation to have a compensation committee, composed entirely of independent directors, with the purpose of determining executive compensation and other related matters. The bill would also require the corporation to have an audit committee, composed entirely of independent directors, with the purpose of assisting board oversight of specified aspects of the internal matters of the corporation. The bill would specify the powers and duties of the committees.~~

~~(3) Existing law requires an annual meeting of a corporation's shareholders and requires shareholder approval for certain actions.~~

~~The bill would require shareholder approval for all equity compensation plans and would prohibit a broker from voting a customer's shares at the meeting without the customer's consent.~~

~~The bill would require the chief executive officer of the corporation to report annually to the Department of Corporations relative to the corporation's procedures to ensure accuracy and completeness of information provided to investors and on other related matters, and would authorize the department to issue a letter of public reprimand to any corporation that violates these procedures.~~

~~(4) This bill would also require foreign corporations to disclose how their governance practices differ from governance practices to California corporations under California law.~~



Vote: majority. Appropriation: no. Fiscal committee: ~~yes~~ *no*.
State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. Section 5000.5 of the Business and Professions Code is amended to read:

5000.5. No public member shall be a current or former licensee of the board or an immediate family member of a licensee, or be currently or formerly employed by, or represent, a public accounting firm, bookkeeping firm, or firm engaged in providing tax preparation as its primary business, or have any financial interest in the business of a licensee. Each public member shall meet all of the requirements for public membership on the board as set forth in Chapter 6 (commencing with Section 450) of Division 1.

~~SEC. 2. Section 171.09 is added to the Corporations Code, to read:~~

~~171.09. (a) "Independent director" means a director affirmatively determined by the board to have no material relationship with the corporation, either directly or as a partner, shareholder, or officer of an entity that has a relationship with the company.~~

~~(b) A director who is or in the previous five years has been any of the following, or who has an immediate family member who is or in the previous five years has been any of the following, may not be determined to be an independent director:~~

~~(1) An employee of the corporation.~~

~~(2) A person affiliated with or employed by a present or former auditor of the corporation or an affiliate of the corporation.~~

~~(3) A person who is or has been part of an interlocking directorate in which an officer of the corporation serves on the compensation committee of another corporation that employs the director.~~

~~SEC. 3. Section 301 of the Corporations Code is amended to read:~~

~~301. (a) Except as provided in Section 301.5, at each annual meeting of shareholders, directors shall be elected to hold office until the next annual meeting. However, to effectuate a voting shift (Section 194.7) the articles may provide that directors hold office~~

1 for a shorter term. The articles may provide for the election of one
2 or more directors by the holders of the shares of any class or series
3 voting as a class or series.

4 (b) Each director, including a director elected to fill a vacancy,
5 shall hold office until the expiration of the term for which elected
6 and until a successor has been elected and qualified.

7 (c) (1) Notwithstanding any other provision of this code, on
8 and after January 1, 2006, a majority of the directors shall be
9 independent directors. The corporation shall make a public
10 disclosure at the point in time at which a majority of its directors
11 are independent directors.

12 (2) This subdivision shall only apply to corporations organized
13 under this division that are not listed on the New York Stock
14 Exchange.

15 SEC. 4. Section 301.1 is added to the Corporations Code, to
16 read:

17 301.1. Sections 301.2, 311.1, 311.2, 311.3, 319, 320, 606, and
18 1513 shall only apply to corporations organized under this title that
19 are not listed on the New York Stock Exchange.

20 SEC. 5. Section 301.2 is added to the Corporations Code, to
21 read:

22 301.2. The independent directors of the corporation shall
23 meet at regularly scheduled executive sessions without the
24 presence of management at those executive sessions. The
25 independent directors shall designate, and publicly disclose, the
26 name of the independent director who will preside at those
27 executive sessions.

28 SEC. 6. Section 311.1 is added to the Corporations Code, to
29 read:

30 311.1. (a) A corporation shall establish a nominating and
31 corporate governance committee that is composed entirely of
32 independent directors.

33 (b) The nominating and corporate governance committee shall
34 have a written charter that addresses all of the following:

35 (1) The purpose of the committee, which at a minimum shall
36 be to identify individuals qualified to become directors, to select,
37 or to recommend that the board select, the director nominees for
38 the next annual meeting of shareholders, and to develop and
39 recommend to the board a set of corporate governance principles
40 applicable to the corporation.

1 ~~(2) The committee's goals and responsibilities, including, at a~~
2 ~~minimum, the board's criteria for selecting new directors, and~~
3 ~~oversight of the evaluation of the board and management.~~

4 ~~(3) An annual performance evaluation of the committee.~~

5 SEC. 7. ~~Section 311.2 is added to the Corporations Code, to~~
6 ~~read:~~

7 ~~311.2. (a) A corporation shall establish a compensation~~
8 ~~committee that is composed entirely of independent directors.~~

9 ~~(b) The compensation committee shall have a written charter~~
10 ~~that addresses all of the following:~~

11 ~~(1) The purpose of the committee, which at a minimum shall~~
12 ~~be to discharge the board's responsibilities relating to~~
13 ~~compensation of the corporations officers, and to produce an~~
14 ~~annual report on executive compensation for inclusion in the~~
15 ~~corporation's proxy statement in accordance with applicable laws~~
16 ~~and regulations.~~

17 ~~(2) The committee's duties and responsibilities, including, at a~~
18 ~~minimum:~~

19 ~~(A) The review and approval of corporate goals and objectives~~
20 ~~relating to compensation of the chief executive officer, an~~
21 ~~evaluation of the chief executive officer's performance in light of~~
22 ~~those goals and objectives, and the establishment of the chief~~
23 ~~executive officer's compensation based on this evaluation.~~

24 ~~(B) The making of recommendations to the board with respect~~
25 ~~to incentive compensation plans and equity-based plans.~~

26 ~~(3) An annual performance evaluation of the committee.~~

27 SEC. 8. ~~Section 311.3 is added to the Corporations Code, to~~
28 ~~read:~~

29 ~~311.3. (a) A corporation shall establish an audit committee~~
30 ~~that is composed entirely of independent directors. In addition, a~~
31 ~~director that is an independent director may not be the chairperson~~
32 ~~of, or a voting member of, the audit committee if the director holds~~
33 ~~20 percent or more of the corporation's shares, or if the director is~~
34 ~~a general partner, controlling shareholder, or officer of any person~~
35 ~~who holds 20 percent or more of the corporation's shares.~~

36 ~~(b) The only compensation that a member of the audit~~
37 ~~committee may receive from the corporation is the fee payable to~~
38 ~~a director.~~

39 ~~(c) The chairperson of the audit committee shall have~~
40 ~~accounting or related financial management expertise.~~

~~(d) The powers and duties of the audit committee shall include, but not be limited to, all of the following:~~

~~(1) The committee shall have the sole authority on behalf of the corporation to hire and fire independent auditors, and to approve any significant nonaudit relationship with the independent auditors.~~

~~(2) The committee shall have a written charter that addresses all of the following:~~

~~(1) The purpose of the committee, which at a minimum shall be to assist board oversight of (A) the integrity of the corporate financial statements, (B) the corporation's compliance with legal and regulatory requirements, (C) the independent auditor's qualifications and independence, and (D) the performance of the corporation's internal audit function and independent auditors; and to prepare the report required by rules of the Securities and Exchange Commission for inclusion in the corporation's annual proxy statement.~~

~~(2) The committee's duties and responsibilities, including, at a minimum:~~

~~(A) Hiring and firing the corporation's independent auditors, subject, if applicable, to shareholder ratification.~~

~~(B) On not less than an annual basis, obtaining and reviewing a report by the independent auditor describing the auditor's internal quality control procedures, any material issues raised by the most recent internal quality control review or peer review of the auditor, or by any inquiry or investigation by governmental or professional entities within the preceding five years with respect to one or more independent audits carried out by the auditor and any steps taken to deal with those issues, and all relationships between the auditor and the corporation.~~

~~(C) Discussing the annual audited financial statements and quarterly financial statements with management and the independent auditor, including the company's disclosures included with those statements under the subject "management discussion and analysis of financial condition and results of operations."~~

~~(D) Discussing earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies.~~

1 ~~(E) As appropriate, obtaining advice and assistance from~~
2 ~~outside legal, accounting, or other advisors.~~

3 ~~(F) Discussing policies with respect to risk assessment and risk~~
4 ~~management.~~

5 ~~(G) Meeting separately, at least quarterly, with management,~~
6 ~~with internal auditors or other personnel responsible for the~~
7 ~~internal audit function, and with independent auditors.~~

8 ~~(H) Reviewing with the independent auditor any audit~~
9 ~~problems or difficulties, and the response of management to those~~
10 ~~problems or difficulties.~~

11 ~~(I) Setting clear hiring policies for employees or former~~
12 ~~employees of the independent auditors.~~

13 ~~(J) Reporting regularly to the board.~~

14 ~~(3) An annual performance evaluation of the committee.~~

15 ~~SEC. 9. Section 319 is added to the Corporations Code, to~~
16 ~~read:~~

17 ~~319. A corporation shall adopt and disclose its code of~~
18 ~~business conduct and ethics for its directors, officers, and~~
19 ~~employees, and shall promptly disclose any waivers of that code~~
20 ~~that have been granted for directors and officers. The code of~~
21 ~~business conduct and ethics shall cover all of the following areas:~~

22 ~~(a) Conflicts of interest.~~

23 ~~(b) Corporate opportunities.~~

24 ~~(c) Confidentiality.~~

25 ~~(d) Fair dealing.~~

26 ~~(e) Protection and proper use of corporate assets.~~

27 ~~(f) Compliance with laws and rules and regulation, including,~~
28 ~~but not limited to, those dealing with insider trading.~~

29 ~~(g) Encouraging the reporting of any illegal or unethical~~
30 ~~behavior.~~

31 ~~SEC. 10. Section 320 is added to the Corporations Code, to~~
32 ~~read:~~

33 ~~320. (a) The chief executive officer of a corporation shall~~
34 ~~annually certify all of the following to the Department of~~
35 ~~Corporations:~~

36 ~~(1) That the corporation has established procedures for~~
37 ~~verifying the accuracy and completeness of the information~~
38 ~~provided to investors.~~

39 ~~(2) The procedures in paragraph (1) have been carried out by~~
40 ~~persons responsible to the corporation.~~

~~(3) That, based upon the chief executive officer's assessment of the adequacy of the procedures in paragraph (1) and the diligence of those persons charged with carrying them out, the chief executive officer has no reasonable cause to believe that the information provided to investors is inaccurate or incomplete in any respect.~~

~~(4) The chief executive officer has reviewed the procedures in paragraph (1) and compliance with those procedures with the board of directors, and is not aware of any violation of those procedures by the corporation.~~

~~(b) The department may issue a public letter of reprimand to a corporation that is in violation of the procedures in paragraph (1) of subdivision (a).~~

~~SEC. 11. Section 606 is added to the Corporations Code, to read:~~

~~606. Shareholder approval shall be required on all equity compensation plans. A broker may not vote the shares of a customer of the broker unless the broker has received instructions from the customer to do so.~~

~~SEC. 12. Section 1513 is added to the Corporations Code, to read:~~

~~1513. A corporation shall publicly disclose all of the following of its corporate governance guidelines:~~

~~(a) Director qualification standards.~~

~~(b) Director responsibilities.~~

~~(c) Director access to management, and as necessary and appropriate, to independent advisors.~~

~~(d) Director compensation.~~

~~(e) Director orientation and continuing education.~~

~~(f) Management succession.~~

~~(g) Annual performance evaluation of the board.~~

~~SEC. 13. Section 2118 is added to the Corporations Code, to read:~~

~~2118. A foreign corporation doing business in this state shall publicly disclose to what extent, if any, its corporate governance practices under the laws of the jurisdiction in which it is incorporated vary from the laws applicable to California corporations.~~